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UPDATE OF CHANGES IN STATE RETAIL RATE REGULATION OF LECs OCTOBER 2005 – JULY 15, 2006

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SUMMARY

This short report summarizes some of the changes that occurred in state retail rate regulation of local exchange carriers (LECs) since our last report, which includes data as of September 2005. States have been very active in the area of rate regulation during the last ten months, approving new state laws, regulatory plans for one or more of their LECs, as well as approving petitions for rate deregulation of basic residential and business services, as well as non-basic services in competitive areas.

Since September of 2005, five states (IN, KS, KY, MI and MS) have adopted laws deregulating rates for retail services; New Hampshire's legislature passed a similar bill and Oregon's PUC is working on a straw proposal for telecom rate deregulation. In contrast, Florida is revising a deregulation law passed in 2003 to limit some of its provisions for local basic service rates. The new rate regulation plans adopted in seven states (AZ, NJ, NM, NY, NC, OH and VT) show some common trends: Increased pricing flexibility; provisions allowing carriers to rise rates for stand-alone single-line basic residential services; rate deregulation of retail bundled services; as well as, the development of opt-in plans for small carriers, currently under rate-of-return (ROR) regulation, that allow them to shift to alternative forms of regulation, mostly price cap regulation.

Finally, eight states (GA, IL, IA, MO, RI, TN, TX, and WI) have approved rate deregulation of services for different carriers during this period. Of them, five states deregulated basic residential and/or business services in markets deemed competitive. Competition, for the most part, is defined as the existence of at least one facilities-based competitor and another carrier competing with the incumbent. Texas has adopted more stringent criteria for rate deregulating its smallest markets (less than 30,000) by requiring that at least three competitors serve the same market as the incumbent. The Bells and Sprint keep obtaining approval for rate deregulation in the largest urban areas. Rhode Island is an interesting case, as its PUC has approved rate deregulation of Verizon's residential basic service across the state, based on the level of competition faced by the incumbent. These trends will continue in the near future, as evidenced by the list of pending bills, regulatory plans, and petitions for deregulation.

The information included in this report was obtained from news clips published in *State Telephone Regulation Report*.

NEW STATE LAWS PASSED

IN (HEA-1279, March 28 2006): Phases-out retail telephone rate regulation by June 30 2009. During the transition period (March 2006-June 2009), carriers may raise the flat monthly rate for basic local service up to $1 annually, not to exceed $3 for the whole transition period. Carriers must offer the option of flat-rate unlimited local calling service. Non-basic services rates were deregulated instantly. VoIP, broadband, wireless and information services are outside URC's jurisdiction. Carriers will have to offer broadband services to at least 50 percent of subscribers within 18 months of their first basic-service rate increase.

KS (SB-350): The law deregulates retail rates for bundled telecom services statewide and all stand-alone services, other than basic exchange service, to customers under five lines. Markets with more than 75,000 inhabitants are presumed competitive and were deregulated immediately. Rates for deregulated services can be set at any point above a cost floor. The law allows deregulation in smaller markets based on a competition test (at least two carriers competing against the incumbent: one facilities-based carrier and another type of carrier; resellers and prepaid service providers are not considered). Re-regulation is permitted if fewer than two carriers compete against the ILEC, or due to a carrier's failure to correct service quality violations. The Commission is required to submit a report to the state legislature every three years studying the impact of deregulation on local rates and the potential need to change the deregulation law.

KY (HB-337): Proposes an opt-in alternative regulation program for ILECs. The law deregulates rates for all but basic single-line local service by July 12. Large ILECs opting in would have rates for basic exchange frozen for five years at level equal to rates current at time of election; afterwards, the law allows annual rate changes equal to national Consumer Price Index (CPI), subject to PSC approval. Basic exchange rates for small ILECs (under 50,000 lines) are frozen for 12 months at the rate level current at the time of election and then can increase based on the CPI. All other retail non-basic service rates are deregulated. BS is currently under this program; the other 18 ILECs have the alternative to opt-in.

MI (HB-5327; into effect since April 1, 2006): The new Michigan Telecommunication Act deregulates rates for all retail telecom services other than residential dial tone with a 100-call monthly allowance. The basic exchange rate is frozen for five years. The reasonableness of the starting rates for regulated single-line basic exchange service that would apply for the next five years is being disputed by the state's Attorney General Michael Cox (R).

MS (HB-1252): This law deregulates rates for most stand-alone retail telecom services and all retail service bundles. Single-line stand-alone flat-rate local exchange service and intrastate switched access service remain rate regulated. The law requires carriers to provide service to any customer as long as the cost of extending the service is under $5,000.

Pending bills

FL (SB-142): The state legislature has passed a bill that would repeal parts of a 2003 state deregulation law. The bill shifts the approved 20 percent annual raise on local basic service to increases limited to a cap of CPI-1 percent. The bill also deletes a provision allowing LECs to classify noncompetitive services as competitive, now requiring LECs to justify such reclassification before the PSC.

NH (HB-1756): The bill was passed by the state legislature. If signed, it would allow PUC to re-impose ROR on small ILECs or revise the price control program applied to these carriers if competition dwindles or due to a carrier's failure to comply with Universal Service or intercarrier service obligations. Staring rate for basic exchange service provided by small carriers would be capped at Verizon's level. Rate increases capped at 10 percent annually for cost increases with uncontrollable external causes (tax increases or government mandates).

OR: The PUC's "straw proposal" for telecom rate deregulation was sent for study to the Telecom Deregulation Task Force, a force ordered by the 2005 legislature. The proposal freezes stand-alone residential basic exchange rates; retains rate regulation of directory assistance, other operator services, EAS, and intrastate access charges, and deregulates bundled services, residential vertical services and other optional or discretionary residential services. The next meeting of the Task Force is scheduled for July 25th.

NEW RETAIL RATE REGULATION PLANS FOR ONE OR MORE LECS

AZ – Qwest: Approval of pricing flexibility regime that will provide Qwest a net $43.8 million revenue increase over two years to correct a detected revenue deficiency. The plan extends price cap rules through 2007. Rates for basic exchange service, 911 and in-state directory assistance are capped at current levels. Qwest is allowed to raise rates for vertical services and other services classed as semi-competitive up to 25 percent. Fully competitive services would be priced to market. In exchange, Qwest is to cut intrastate access charges by $12 million the first year and withdraw a proposal to declare major cities as competitive zones, which would then be deregulated.

NJ – United Telephone: Sprint, the Office of Ratepayer Advocate and the staff of the Board of Public Utilities (BPU) reached an agreement on the spin-off of the operation of Sprint's wireline local exchange in the state, required under the terms of its merger with Nextel. United's local rates will be frozen at current levels until 2008. Services classed as rate-regulated cannot be moved into the deregulated competitive category for the next 18 months. The company will also expand broadband availability, establish discounted rates for schools and libraries and expand eligibility criteria for Lifeline.

NM – Valor Telecom: Following a 2004 New Mexico's law mandate to establish a more liberal regulatory system for midsize ILECs (50,000-375,000 lines), the PRC revised Valor's regulatory regime in 2005. Valor is the only incumbent currently covered by this law, but its regulatory plan will apply to any other midsized local provider entering the state through 2010. As of April 1, 2006, the new five-year plan deregulates rates for retail service bundles, except that they must be priced above cost. Stand-alone basic service rates could be set anywhere between current rates and a cost floor. Non-basic services can rise five percent per year, while vertical services are allowed to rise 20 to 50 percent annually, depending on the service. The PRC will revisit the rules in 2007 for necessary adjustments. (Case 05-00282-UT).

NY – Verizon, Frontier Telecom, and other incumbents: A new PSC policy allows Verizon to raise monthly unlimited basic local rates up to $2 a year to a statewide cap of $23. The dial-tone portion of measured local service can be increased by the same amount the first two years. Frontier can increase its flat and measured rates $2 a year for two years; afterwards increases to basic rates must have PSC approval. Other incumbents must justify any increase to basic local rates by showing evidence of cost rises or the existence of competition. VZ and Frontier's rates for vertical services and other non-basic services are deregulated, with the requirement to maintain a uniform charge for rate deregulated services across their service territories. Other incumbents may obtain pricing flexibility for non-basic services by showing evidence of sufficient competition. (Case 05-C-0616).

NC – Alltel: Tentative approval by the Utilities Commission of a new price cap plan, similar to those of BS, VZ and Sprint. The plan will allow annual rate increases for basic service of up to ten percent, subject to a revenue cap for the basic basket equal to 1.5 times the annual inflation rate as measured by the GDP-PI. Vertical and non-basic services are allowed to rise up to 20 percent subject to a basket revenue cap equal to 2.5 times the annual GDP-PI. Competitive services are rate deregulated. (Case P-118, Sub 86).

OH – Other incumbents: PUC adopted a relaxed regulatory framework for small incumbents (under 50,000) in the state as an alternative to ROR regulation. For-profit small ILECs lines that opt into the plan would have to freeze their basic local rates indefinitely, as well as their vertical rates for the first two years. Other services are flexibly priced. Small incumbents have advanced service requirements that can be fulfilled through an affiliate company; carriers are also required to develop a Lifeline outreach program in collaboration with PUC staff. Not-for-profit small incumbents, including cooperatives, are allowed to change rates for any service n 30 days notice to customers, without PUC review. These carriers only have to fulfill their federal Lifeline obligations. (Case 05-1304-TP-COI).

ILECs facing competition in basic local services: Based on a 2005 law, PUC adopted new price cap rules for ILECs facing local competition. These rules allow raises or cuts to basic exchange rates up to $1.5 monthly, substituting a previous cap that froze basic service rates. Competition is defined as the existence of competitors having at least a 20 percent market share systemwide or a 25 percent share in competitive exchanges. Carriers can also qualify for the new pricing flexibility regime by showing a 15 percent line loss to at least two different local competitors or evidence of five or more local providers servicing customers in its markets.

Verizon and Champaign Telephone: Companies were allowed to switch from ROR regulation to an alternate price cap framework. The plan freezes basic exchange and caller ID rates. It also limits increases for certain vertical and specialty business services for 24 months. After this period, rates can rise to an absolute cap set at double the current rates. Most other retail rates are deregulated. The plan requires VZ to extend broadband services to specific unserved areas and expand Lifeline eligibility.

VT – Verizon: The Public Service Board approved an amendment to the carrier's price regulation plan replacing an annual $40 million infrastructure investment requirement with a mandate to make broadband service available to 80 percent of its access lines by 2010. Verizon currently has broadband services available in 56 percent of its lines. To reach the required 80 percent, Verizon will have to upgrade about 80,000 lines in four years, using either landline or wireless technologies.

Plans in process

NH – Verizon: The PUC set a hearing on October 10 on a new price-based regulation plan for Verizon that would move the carrier out of ROR regulation. The proposed plan would cap residential basic rates at current levels and deregulate rates for other retail services. The plan has been opposed by the state Office of Consumer Advocate. (Case DT 06-072).

NM – Qwest: The PRC ordered in March 2006 an interim extension of the carrier's price cap regulation until a new plan could be negotiated. The delay in considering Qwest's new plan was due to litigation on Qwest's 2001 plan's investment requirements. The extension continues the 2001 plan without change. The PSC set a schedule for consideration of the proposed plan, to take effect before October 2006. The plan as proposed by Qwest would keep rates for stand-alone basic residential and business services at current levels and give Qwest price flexibility to adjust rates for bundled services.

DEREGULATION OF SERVICES FOR ONE OR MORE LECS

GA – BellSouth: BellSouth's agreed with PSC to detariff the carrier's new, bundled and contracted retail services, as well as some existing optional and discretionary services, due to the existence of equivalent alternatives. PSC retains authority to resolve complaints on detariffed services and may impose penalties in case of violations to service contracts. (Case 20729-U).

IL – AT&T: The state Supreme Court reinstated a 2001 state law deregulating rates for all business telecom services for the company. (Case 99380).

IA – Frontier Communications, IA Telecom and Qwest: Approval of retail rate deregulation of single-line residential and business services in four of Qwest's exchanges, 14 exchanges of Iowa Telecom and two Frontier exchanges, based on evidence of effective wireline competition. (Case NU-05-2).

MO – AT&T and Sprint: The PSC approved the deregulation of 26 residential and 45 business markets served by AT&T as a result of existing competition. Deregulation of other 19 exchanges was denied due to failure to meet competitive criteria or to late additions to the petition. A 2005 law defined a competitive market as that with at least one facilities-based wireline CLEC and one wireless competitor providing local service. As part of this case, the PSC also rate deregulated five of Sprint's exchanges in the state. (Case IO-2006-0092).

A second case seeks rate deregulation in an additional 49 residential and 26 business exchanges served by AT&T under an alternative 60-day process for markets with competition, but where there is no facilities-based CLEC providing service. The two petitions would deregulate approximately two thirds of AT&T's exchanges in the state. Final decision on the second petition is scheduled for October. (Case IO-2006-0102)

RI – Verizon: The PUC approved Verizon's petition for statewide rate deregulation of residential basic service based on evidence of about 35 percent of residential lines served by competitors. Retail rates for optional, discretionary, and basic business services had previously been deregulated. PUC also granted a request for Verizon to cut its Lifeline subsidy by $2 monthly, to bring it in line with its competitors' level. Verizon is still required to file annual earning reports and monthly service quality reports.

TN – BellSouth, Citizens Telecom: All retail toll and high speed digital services for businesses were approved for deregulation. (Case 03-00391).

TX – AT&T, Verizon and Sprint: Following a 2005 law mandate to rate deregulate by Dec. 31 2005 markets with 30,000-100,000 population if there were at least three local competitors, the PUC approved retail rate deregulation in 14 midsized local markets served by AT&T, three Verizon markets and one Sprint market. Markets that did not fulfill the competition requirements will remain rate regulated. (Case 31831). The same law requires the PUC to determine which markets with population under 30,000 must remain under rate regulation by November 2006 (Case 32169). All markets over 100,000 lines were rate deregulated by law.

In June 2006 the PUC adopted a new set of rules for determining the markets with populations of less than 30,000 that should remain rate regulated. Under the revised §65.002 of the Public Utility Regulatory Act (PURA), rate deregulation occurs only if the ILEC demonstrates that the population in the market is less than 30,000 and that it faces competition from three separate carriers, of which at least one must be a facilities-based competitor and at least two competitors must be from two different categories of the following: (A) a certified provider of residential local exchange telephone service in the market; (B) a CMRS provider in that market that is not affiliated with the ILEC; and (C) a satellite telecommunications provider certified as an eligible telecommunications carrier for the entire market. CRTCs under Section 251 (f)(1) rural exemption may petition the PUC for a waiver of such exemption, so that the market in question may be rate deregulated. Markets shall be deregulated on January 1, 2007 only if the ILEC providing service to such a market(s) submits evidence on or before August 1, 2006.

WI – AT&T (SBC): The PSC granted SBC rate deregulation of basic residential service in the state's 17 largest cities and suburbs, covering about 75 percent of its residential customers. Annual increases in residential basic exchange rates are limited to $2.50 monthly in the first two years. Starting in 2008, AT&T will be able to price this service at market rates. Deregulation lifted an $8.20 monthly residential price cap for about 300,000 residential urban and suburban customers in Milwaukee, Green Bay, Madison and other large cities. The cap remains in effect for another 120,000 customers in rural areas. Rates for business service, toll and most optional or discretionary services were previously deregulated. (Case 6720-TI-196).

Petitions for service deregulation

IL – AT&T: Petitioned to deregulate retail rates for residential voice service in the Chicago area due to existence of effective competition. (Case 06-0027). This service is currently under indexed price caps. AT&T and Illinois' Citizens' Utility Board reached an agreement in May, but the petition still requires approval by the state's Commerce Commission.

MO - Embarq: The PUC is scheduled to decide on a petition by Embarq (Sprint's former local exchange operations in the state) for rate deregulation of all retail residential services, except basic exchange in seven communities, due to growing competition from wireline and wireless providers. It is also seeking rate deregulation of all business services in Lebanon due to competition.

MT – Qwest: Petitioned to deregulate optional vertical services, additional-listing services and bundled packages for residential and business customers, based on existing level of competition. Hearings start Oct. 4, 2006. (Case D-2006-3-39).

OTHER CHANGES

NM – Qwest: The NM Supreme Court ruled that the Public Regulation Commission has the authority to force a $220 million refund by Qwest that the carrier failed to invest in its network as required in its 2001 regulatory plan. The PRC will give Qwest the opportunity to propose alternatives to the refund, such as a new investment plan.

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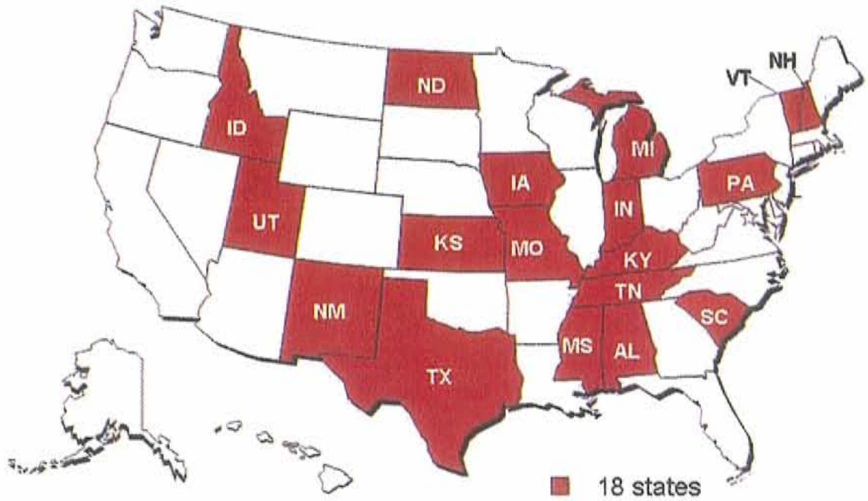
Adoption of new state laws affecting retail rate regulation
(October 2004 – July 2006)



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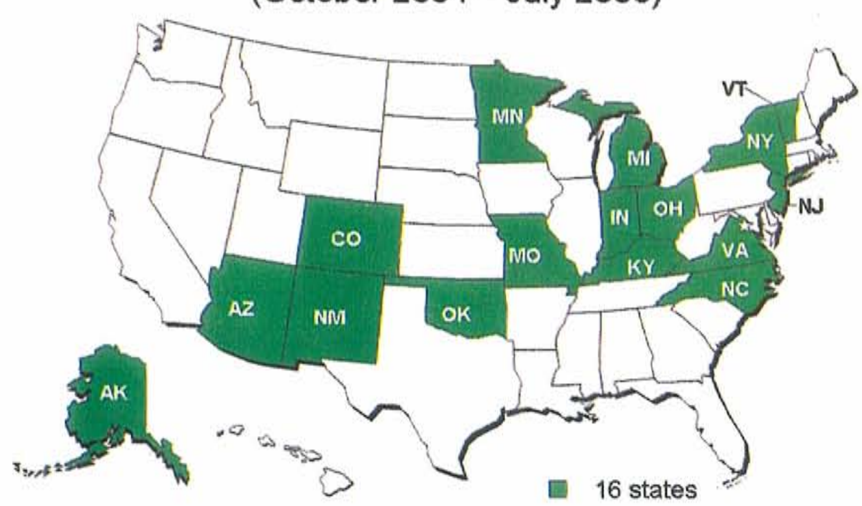
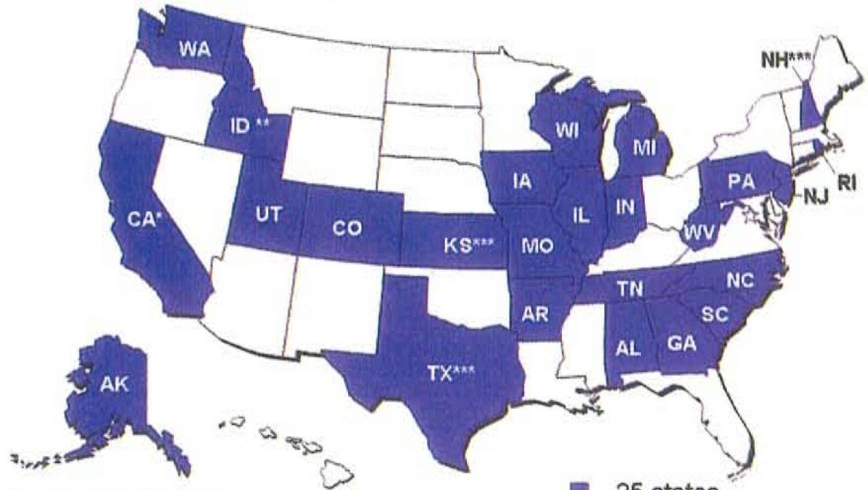
Adoption of new retail rate regulation plans for one or more LECs
(October 2004 – July 2006)



Retail rate deregulation of service(s) provided by one or more LECs
(October 2004 – July 2006)



* Plan being reviewed
** After current caps expire
*** Option if competition exists or based on population size